VZCZCXRO1761
PP RUEHCHI RUEHCN RUEHDT RUEHGH RUEHHM RUEHVC
DE RUEHHK #0869/01 1320703
ZNR UUUUU ZZH
P 120703Z MAY 09
FM AMCONSUL HONG KONG
TO RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUEHC/SECSTATE WASHDC PRIORITY 7589
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHOO/CHINA POSTS COLLECTIVE

UNCLAS SECTION 01 OF 02 HONG KONG 000869

SIPDIS

STATE FOR EAP/CM AND EEB/OMA, TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: ECON EFIN HK CH
SUBJECT: IMF TELLS ASIAN ECONOMIES TO SPEND MORE, DON'T RELY ON CHINA

¶1. Summary: Trade linkages among Asian economies amplified the impact of the global financial crisis to a degree that surprised International Monetary Fund economists, said Assistant Director for Asia Joshua Feldman in Hong Kong at the release of the Fund's Regional Economic Outlook report on May 8. Declines in regional exports are slowing and Chinese government spending is supporting growth there. But the Chinese stimulus package is focused on projects that will boost its own domestic economy and will not help the rest of the region. Asia's recovery will depend on the return of consumer demand in the U.S. and Europe, the prospects for which are not good. Instead of waiting for western consumers to return to their free-spending ways, the Fund is advising Asian economies to spend more and relax monetary policy, while pushing development of domestic markets. Commenting on the Fund's report, Morgan Stanley's Stephen Roach noted that policy prescriptions that rely on a return of western consumer demand are misguided and doomed to fail. Others agreed that Asian economies need to stimulate domestic demand, but argued that just as Asia's trade supply chain amplified the impact of falling consumer demand, it would also amplify the recovery. End Summary.

IMF's New Prescription for Asia: Spend More

¶2. Representatives from the International Monetary Fund (IMF) presented their May 2009 Regional Economic Outlook (REO) report at the Hong Kong Monetary Authority May 8. They noted that the severe impact of the global economic crisis on Asian economies had caught them by surprise. Banks and other financial institutions in the region were not particularly exposed to subprime lending or exotic financial paper that led to serious problems in the United States and Europe. Local economies appeared to be on relatively sound macroeconomic footing. However, Fund economists said they had underestimated the degree to which the trade linkages in Asia amplified the impact of collapsing demand for Asian manufactured goods in those economies hit most directly by the crisis. Asian financial institutions' ties with the rest of the world have also deepened, leaving borrowers in the region subject to difficulties in obtaining credit.

¶3. The Fund representatives noted that declines in regional exports and industrial production are starting to slow and that some are saying a recovery is imminent. China, in particular, is experiencing a surge in investment and bank lending. The Fund, however, is not optimistic that Chinese stimulus will help the rest of the region, much less the global economy, pull out of the current recession. They noted that much of the current Chinese stimulus package is directed towards infrastructure development that uses mostly domestic inputs of raw materials and labor, and will not substantively benefit other economies in the region. Fund economists said Asian recoveries have been characterized by

slow recovery of investment and domestic demand and they warned that lack of access to capital could start a negative feedback loop as bankruptcy risk made banks even more reluctant to lend. Asia's recovery will depend on the recovery of demand in the U.S. and Europe, where financial difficulties are likely to depress growth through 2010, said Fund representatives.

¶4. In the immediate term, the Fund advised Asian economies to maintain countercyclical monetary and fiscal policies, even if key economic indicators begin to look positive, in order to offset any unexpected risks. The Fund also advised a shift away from export-led growth and the development of domestic demand as a means to speed the return to pre-crisis growth rates. Building social protection systems to reduce savings now needed for health, education and retirement expenses and exchange rate appreciation would be helpful.

=== ====
Local Economists Agree, Warn on Export Dependence
=== ====

¶5. A panel of locally-based economists all substantively agreed with the IMF's assessment of the crisis and the appropriate Asian policy response. Morgan Stanley's Asia Chairman Stephen Roach told the assembled audience that Asian leaders are in denial and mistakenly using the same playbook as during previous economic crises. The growth in global trade over the past 10 years has allowed Asian economies to prosper, but regional economies have no backup plan, said Roach. China is returning to the same policies that worked so well in the Asian and Dot.com crises: government spending

on infrastructure to tide the economy over until export demand picks up again. The problem is that U.S. and European demand will not return to the same levels, and there is no way for the rest of the world to make up the difference, he said.

¶6. Deutsche Bank Chief Asian Economist Michael Spencer agreed with the Fund's analysis, though he was less concerned about the possibility of negative feedback loops. He noted that the impact of the crisis on Asia's economies was amplified by their logistical and manufacturing chains, but that the impact of a western economy recovery would also be amplified. The nimbleness of Asian manufacturers is likely to help them recover more quickly, he said. Spencer worried that the Fund was encouraging continued fiscal stimulus in some Asian economies that would quickly find themselves in untenable fiscal positions. He agreed, however, that a loose monetary policy would help spur economic activity and pointed out that falling inflation rates argued for even lower interest rates. Hong Kong Baptist University professor Wong Kar-yiu agreed that fiscal stimulus would help, but he noted that for most economies, government spending is only a fraction of consumer spending and cannot counteract a sharp drop in consumption.
DONOVAN